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June 8, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

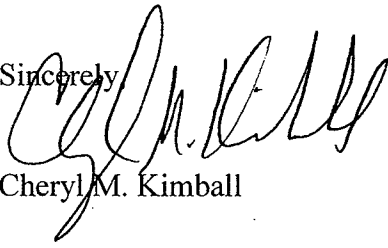
Re: Southern Union Company, D.T.E. 05-38

Dear Secretary Cottrell:

Enclosed please find the responses of Southern Union Company to the Department of Telecommunications and Energy's First Set of Information Requests in this above-referenced proceeding. Please do not hesitate to contact me if you have any questions or if I can provide you with any additional information.

Thank you for your attention to this matter.

Sincerely,



Cheryl M. Kimball

Enclosures

cc: Elizabeth A. Cellucci, Hearing Officer
Mauricio Diaz, Rates and Revenues Division
Paul Osborne, Rates and Revenues Division
Mark Barrett, Rates and Revenues Division
Joe Passaggio, Rates and Revenues Division
John Cope-Flanagan, Legal Division

Information Request DTE 1-1

Refer to page 6 of Exhibit SU-1. Please provide additional comment on the advisability of using earnings and cash generated by distribution operations (*i.e.* equity) to repay long-term debt. In addition, please explain how the Company's equity ratios improve, for ratemaking purposes, by substituting higher priced equity for long-term debt.

Response

The issuance of a stock dividend enables the Company to retain and use the earnings generated by its operations to finance utility operations and repay long-term debt, rather than paying out those earnings in the form of a cash dividend. By using earnings in this manner, the Company is able, in part, to avoid turning to the capital markets to raise the levels of debt and equity capital that would be needed if earnings were paid out in cash to shareholders each year.

In addition, the Company uses cash generated by its distribution operations to repay long-term debt. When the need for new long-term debt is avoided and existing debt is repaid, the Company's debt-to-equity ratios improve because the debt component of capitalization becomes a smaller percentage of the total and the equity component becomes a larger percentage. Thus, the issuance of a stock dividend is an important tool for the Company in maintaining and improving cash flow and achieving appropriate balance sheet capitalization ratios.

As noted in the question, equity tends to be a "higher" cost source of capital than long-term debt. However, as the Department has long recognized, sound utility practice dictates that utility companies maintain a capital structure that is appropriately balanced between debt and equity. An appropriate balance ensures that the utility company is not overly leveraged (by being too dependent on debt as a source of capital) and does not impose undue cost burdens on customers (by having an "excessive" level of equity). The Department has typically encouraged a 50-50 split between debt and equity because this ratio is recognized under traditional financial theory and credit analysis to be a favorable balance. Because the Company's growth strategy has involved merger and acquisition activities funded in large part through debt, the stock dividend policy has served as an important tool in maintaining debt-to-equity ratios in a favorable balance. Even with 10 years of stock dividends completed, equity ratios are well within a favorable balance.

It is for this reason that the Company's adherence to the stock-dividend policy has been viewed favorably by the major credit-rating agencies. By conserving cash and retaining earnings within the business, the Company has been able to manage its debt levels and maintain an appropriate balance of debt and equity in the capital structure. This puts the Company's creditors in a more secure position thereby ensuring that low-cost capital remains available to the Company, which is an important factor for customers.

Information Request DTE 1-2

Refer to pages 6 and 7 of Exhibit SU-1. Given Mr. Marshall's testimony that the majority of the Company's equity financing since 1994 has resulted from the contribution of retained earnings to the funding sources used by the Company, would it be fair to characterize Southern Union's dividend policy as a source of capital?

Response

The Company's common stock dividend policy is not "a source of capital." The statement at pages 6 and 7 of Exhibit SU-1 notes that it is the *contribution of retained earnings* to the funding sources that has obviated the need for traditional equity issuances. Under Department precedent, retained earnings are considered to be a component of common equity because (cash) earnings are a funding source to the utility. The Company does not receive any funds from the issuance of shares to complete the stock dividend. Absent the accounting treatment for retained earnings when a stock dividend takes place, the dividend operates only as a stock split. Under Department precedent, a stock split provides no source of capital to the utility and has no impact on the utility's capital structure. Significantly, the Company would have equal access to retained earnings with a cash-dividend policy in place because it could always choose not to distribute the dividend and, instead, to conserve its cash (earnings) for use to pay down debt or fund ongoing operations.

Information Request DTE 1-3

Refer to page 7 of Exhibit SU-1. Given the testimony that, because of the stock-dividend policy, the Company can deleverage quickly without the need to raise common equity through public market issuances, would it be fair to characterize Southern Union's dividend policy as a source of capital?

Response

Please see the response to Information Request DTE 1-2. The Company's common stock dividend policy is not "a source of capital." The Company is able to pay down long-term debt with the use of earnings. Earnings may be retained by the Company regardless of the dividend policy in place.

Information Request DTE 1-4

Refer to page 8 of Exhibit SU-1. Given the testimony that Fitch Ratings lists the Company's dividend policy as one of its "Key Credit Strengths" because the no cash dividend policy maximizes cash flow, would it be fair to characterize Southern Union's stock dividend policy as a source of capital?

Response

The Company's common stock dividend policy is not "a source of capital." Please see the response to Information Request DTE 1-2. As suggested by the phrase "no cash dividend policy," earnings may be retained by the Company regardless of the dividend policy in place. If the Company elected to conserve its cash to pay down debt, it could simply reduce or eliminate a cash dividend in any given year, if a cash dividend policy were in place. Accordingly, the Company's choice of "dividend policy" is not a source of capital.

Information Request DTE 1-5

Refer to pages 8 and 9 of Exhibit SU-1. Would replacing the Company's stock dividend policy with cash dividends diminish the value of the Company's equity in the eyes of its shareholders, and if so, why?

Response

The "value of the Company's equity in the eyes of shareholders" is a function of any number of considerations and assumptions made by investors, all of which are unknown to the Company. The value placed on the Company's stock by investors may be affected by a range of factors, including market conditions, investor confidence, investment strategies and options, national economic and political events, weather, gas-supply prices, customer growth, industry trends and changes in regulatory or accounting requirements. The substitution of a cash dividend for the stock dividend may be attractive to some investors (and potential investors) and unattractive for other investors. There simply is no way for the Company to determine the basis on which investors are valuing the Company's stock.

However, the Company does know that a significant factor in maintaining its share price is its ability to produce *investment results* for shareholders, rather than whether the dividend comes in the form of stock or cash. In that regard, the Company's history of investment returns has enabled the Company to maintain share prices without the payment of a cash dividend.

Information Request DTE 1-6

Refer to page 10 of Exhibit SU-1. Will companies paying a stock dividend have a higher equity to debt ratio than companies paying cash dividends?

Response

No. There is no direct connection between the level of equity capitalization in a utility's capital structure and its dividend policy. The capital structure of a utility company is a function of a range of decisions made by the utility regarding the type, scale and timing of capital investments and the decisions to use cash, debt, equity or a combination of those sources to fund those investments. Each and every transaction that the utility enters into that involves a capital investment and coincident funding of that investment will have an impact on the overall capitalization ratios. A company may elect to pay an annual cash dividend and, in addition, may not choose to make any investments funded through debt. The end result could be that the utility has an inordinately high equity capitalization, even with the payment of a cash dividend on an annual basis.

It is incumbent on the utility to undertake the actions necessary to maintain investment-grade ratings for its debt and equity issuances. A balanced capital structure is key to maintaining an investment-grade rating. Therefore, a balance between debt and equity must be achieved regardless of the utility's particular dividend policy.

Information Request DTE 1-7

Refer to Exh. SU-1, page 17, lines 20-22. Assume, for hypothetical purposes, that the market value of the shares to be issued is \$85,000,000 and the retained earnings amount is \$50,000,000. Please describe the journal entries that would be made to account for the stock dividend in the event that the stock dividend exceeds retained earnings. How would the Company account for the difference of \$35,000,000 once the retained earnings account has been zeroed out?

Response

The journal entries required by Generally Accepted Accounting Principles ("GAAP") for the above hypothetical would be as follows assuming the issuance of 5,500,000 shares with a \$1.00 par value per share:

DR	Retained Earnings	\$50,000,000	
CR	Common Stock		\$ 5,500,000
CR	Paid-in Capital		\$44,500,000

When a stock dividend is issued, retained earnings are not reduced below zero in the event that the "market value" of the stock dividend exceeds Retained Earnings. Under GAAP, the actual total amount of Retained Earnings at year end is transferred through the journal entry, *up to the market value of the stock dividend*. This means that, if Retained Earnings at year end are \$50 million and the Company is issuing a stock dividend with a total market value of \$85 million, the Common Stock \$1 Par Value and Premium on Capital Stock accounts are increased *only by \$50 million*. GAAP does not require that the journal entry reflect the market value, unless Retained Earnings equal or exceed the market value.

From a GAAP perspective, the issuance of stock for purposes of distributing a dividend is a stock split, except that the retention of earnings must be recorded as an addition to paid-in-capital. If the Company were to record the remaining \$35 million of "market value" as paid-in-capital, the Company's capitalization would be overstated for financial reporting purposes because *no funds were received by the Company* to constitute capitalization.

Southern Union Company
D.T.E. 05-38
Department of Telecommunications and Energy
Information Request DTE 1-8
June 8, 2005
Person Responsible: Richard N. Marshall
Page 1 of 1

Information Request DTE 1-8

Please refer to Exh. SU-1, page 7, lines 9-11. Provide a breakdown, including issuing costs, of all public offerings issued by the Company since 1994.

Response

Please see the attached schedule listing the public offerings conducted by the Company since 1994.

SOUTHERN UNION COMPANY
NET PROCEEDS FROM COMMON EQUITY PUBLIC OFFERINGS
SINCE 1994

<u>JUNE 11, 2003</u>	<u>Per Share</u>	<u># of Shares</u>	<u>Total</u>
Public Offering Price	\$ 16.000	10,925,000	\$ 174,800,000
Underwriting Discount @ 3.5%	\$ 0.560	10,925,000	6,118,000
Proceeds to Company, before expenses	<u>\$ 15.440</u>	10,925,000	<u>168,682,000</u>
Estimated out-of-pocket expenses			850,000
Net proceeds to Company			<u>\$ 167,832,000</u>

<u>JULY 26, 2004</u>	<u>Per Share</u>	<u># of Shares</u>	<u>Total</u>
Public Offering Price	\$ 18.750	4,800,000	\$ 90,000,000
Underwriting Discount @ 3.5%	\$ 0.656	4,800,000	3,148,800
Proceeds to Company, before expenses	<u>\$ 18.094</u>	4,800,000	<u>86,851,200</u>
Estimated out-of-pocket expenses			1,000,000
Net proceeds to Company			<u>\$ 85,851,200</u>

<u>NOVEMBER 16, 2004</u>	<u>Per Share</u>	<u># of Shares</u>	<u>Total</u>
Public Offering Price	\$ 17.894	8,242,500	\$ 147,491,275
Underwriting Discount @ 3.5%	\$ 0.625	8,242,500	5,151,563
Proceeds to Company, before expenses	<u>\$ 17.269</u>	8,242,500	<u>142,339,712</u>
Estimated out-of-pocket expenses (1)			-
Net proceeds to Company			<u>\$ 142,339,712</u>

<u>FEBRUARY 9, 2005</u>	<u>Per Share</u>	<u># of Shares</u>	<u>Total</u>
Public Offering Price	\$ 23.000	14,913,042	\$ 342,999,966
Underwriting Discount @ 3.0275% (2)	\$ 0.696	14,913,042	10,384,324
Proceeds to Company, before expenses	<u>\$ 22.304</u>	14,913,042	<u>332,615,642</u>
Estimated out-of-pocket expenses			1,000,000
Net proceeds to Company			<u>\$ 331,615,642</u>

Total of Public Offering Prices	\$ 755,291,241
Total of Underwriting Discounts	24,802,687
Total of Out-of-Pocket Expenses	2,850,000
Total Net Proceeds to Company	<u>\$ 727,638,554</u>

(1) The November 16, 2004 sale was the execution of the forward sale that was made in connection with the July 26, 2004 offering, so there were no incremental out-of-pocket expenses.

(2) Because the equity offering was conducted through a private sale, the Company only paid an underwriting fee equal to 86.5% of the customary 3.5% fee. This fee was based upon the Company's contractual obligation with its underwriters.

Information Request DTE 1-9

Please refer to Exhibit SU-1, at 4 and Exhibit SU-3. Please explain why the Company is using 105.6 million shares outstanding as of April 29, 2005 in Exhibit SU-1, at 4, but is using 105.913 million shares outstanding as of March 31, 2005 for purposes of computing the net plant test in Exhibit SU-3.

Response

The reference to "105.6 million shares" stated in Exhibit SU-1, at 4 is to the number of shares *outstanding* as of April 29, 2005. The reference to "105.913 million shares" is to the number of shares *issued* as of March 31, 2005, with the difference being the number of treasury stock issued but not outstanding. Because the stock dividend is distributed to shares *issued*, the Company calculated the net-plant test on that basis.